price decreases for more competitive services with price increases for less competitive services.

First, the baskets and bands are not sufficiently narrowly drawn to accomplish that goal. LEC services now, and even more in the future, cannot be neatly classified as "competitive" and "noncompetitive." In fact, it is more likely that the LEC experiences competition for some customers but not others -- even when these customers purchase the same general service. 12/ Second, because the going-in price cap rate relationships were never established as reasonable, baskets and bands do nothing to correct the preexisting discrimination. Third, over time the LECs have freedom to adjust initial rate relationships to the point where they can become unreasonably discriminatory even if the relationships were reasonable as an initial matter.

To illustrate the need for this modification of price cap regulation, consider the following extremely simple hypothetical scenario. Product A and product B are both LEC access products within the same price cap band and begin with the same price. Product A is a relatively popular high capacity product that accounts for 95 percent of a LEC's revenue in the high capacity band. Product B, another high capacity product, in contrast generates revenues that account for only 5 percent of the total revenues for the band. A LEC could increase the price of product B by 100 percent and still come within the 5 percent limit on increases within the band without even lowering the price of Product A. If the LEC were to lower the price of Product A, it would be able to raise the price of Product B even more. Where product B is used primarily by LEC competitors but product A is not,

12/ Transport is example.

a LEC would have both the ability and the incentive to subject product B to discriminatory price increases. 13/

Nor will local competition someday permit the FCC to lift price cap requirements altogether for LECs, as it has done for AT&T. First, it will be many years before there is substantial competition for any of the LECs' interstate local services, and it is premature, therefore, even to speculate about what might be appropriate at that point. Second, even after substantial loop competition has arrived, continued regulation of access still will be necessary, because the single LEC bottleneck will have been replaced by a multi-bottleneck of competing loop providers, each of whom has bottleneck control with respect to each of their customers. 14/

This potential for unreasonable discrimination within a price cap system is a public policy problem because it can harm competition, as discussed above. The solution is not, however, to multiply the number of baskets and to increase the number of services subject to banding restrictions, although in some cases such measures might be appropriate. Rather, the solution is to address discrimination in rate relationships by adopting cost-based pricing principles that

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13/ This hypothetical demonstrates more than just the theoretical potential for LEC misconduct; it is a description of actual LEC behavior with respect to particular products. For example, over the course of a two year period Southwestern Bell increased the price for its high capacity special access product, dark fiber, by 92 percent. At the same time it was able to decrease the price of another high capacity special access product, DS3 service, without exceeding the price cap basket or band restrictions. See WilTel v. Southwestern Bell Tel. Co., File No. E-94-40 (Complaint filed February 1, 1994), stayed by Common Carrier Bureau Letter Ruling, April 22, 1994. Even more extreme, US West Communications, Inc., in its 1994 Annual Access Filing, increased its dark fiber rates by 100 percent, again without violating the price cap banding restrictions. See WilTel Petition to Reject or Suspend and Investigate, US West Transmittal No. 465 (April 26, 1994).

14/ We discuss this point more fully in connection with the discussion of transitional issues, below.

can be grafted onto price caps and which can restore the basic lawfulness of rate relationships in a price cap environment. Once this is accomplished, but not before, basket and banding constraints can help to keep discrimination in check.

A case in point -- but certainly not the only case -- is the pricing of access transport services. The Commission based the initial rates for transport on the initial special access rates, even though the Commission had never determined that those rates were just, reasonable, and nondiscriminatory, and even though parties, such as WilTel, challenged the cost-based nature of those rate relationships. Price cap baskets and bands do nothing to correct this initial discrimination, and in fact allow LECs substantial flexibility to exacerbate the discrimination by lowering rates for more competitive DS3 and DS1 services and raising rates for tandem-switched service, for which the LECs now face no competition. 15/ WilTel has asked the Commission to reconsider its decisions regarding transport pricing so that the transport rate relationships can be corrected and the consequent harm to long distance competition can be arrested. We incorporate those petitions by reference herein. 16/

15/ The LECs can manipulate the prices for a single service so as to discriminate between customers. For example, CompTel has asked the Commission to reject US West's 1994 annual filing on the ground that US West effectively restructured its tandem-switched transport rates to reduce prices in mileage bands where large carriers disproportionately used the service while increasing rates in mileage bands used by smaller carriers. See CompTel Petition to Reject or Suspend the 1994 Annual Access Tariff Filings (filed April 26, 1994).

16/ WilTel Petition for Reconsideration (filed Dec. 21, 1992), of Transport Rate Structure and Pricing, Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 91-213, 7 FCC Rcd 7006 (1992); WilTel Petition for Reconsideration (filed April 4, 1994) of Transport Rate Structure and Pricing, Second Report and Order, CC Docket No. 91-213, FCC 94-9 (released Jan. 31, 1994).

D. The Commission Should Employ Additional Measures to Address Discrimination.

The Commission has several choices in remedying price discrimination while still retaining the price cap scheme for LECs. First, it could conduct cost studies in an effort to reset the starting point for rates for all price cap services. That task, of course, would be an enormous one -- though perhaps one the Commission should have undertaken before instituting a price cap scheme for the LECs.

Second, the Commission could examine the cost-based nature of the rate relationships for LEC services, a far easier task than attempting to cost-justify absolute rate levels. Thus, for example, it could reset the transport rates to reflect the actual cost relationship among tandem-switched, DS1, DS3, and multiple DS3 services. This WilTel believes to be necessary if the Commission is to avoid long-term damage to telecommunications competition from these discriminatory rates. It also goes without saying that if the BOCs are allowed to provide interLATA service, their incentive and ability to favor themselves in access pricing will elevate the concerns about price discrimination to an even higher level.

A third approach is to "index" price changes for less competitive services to price changes for more competitive services. Under an indexing approach, LECs would have the flexibility to change prices for more competitive services provided that they adjust the prices for less competitive services in a parallel fashion. Such indexing ensures that rate relationships remain nondiscriminatory, while allowing LECs to reduce their rates to reflect the actual declining costs and the competitive pressures they face. 17/

17/ In the transport context, indexing would be accomplished by setting initial transport rate relationships according to relative cost, then requiring any discounts in higher volume services to be reflected as well in parallel discounts in lower volume services (unless the LEC can show that the volume discounts are cost-

A fourth approach to limiting price discrimination would be to limit the presumption of reasonableness for increases in rates for individual services under price caps to rates that increase no more than a certain percentage slightly above the rate of inflation. LECs still would be allowed to justify greater increases on the basis of cost, but the price cap presumption of lawfulness no longer would apply. Capping price increases for individual services would be an administratively simple way to limit the ability of LECs to discriminate and to charge captive customers unreasonably high rates. The simplicity of this approach would allow the FCC to address pricing problems without creating significant administrative burdens, and would not require the FCC to assesses whether a particular service could be classified as competitive or not.

These measures are not mutually exclusive, nor do they eliminate the need to scrutinize initial rates. But they are relatively simple ways to address price discrimination in the context of a price cap scheme that has for the most part departed from cost-based ratemaking.

Baseline Issues 3-6: Overall Rate Level Questions.

E. Overall Price Cap Rate Levels Should be Reduced to a Level Closer to Cost, and Reductions Should Be Used to Correct Discrimination

It goes without saying that unless the overall price cap index is set properly, all rates under price caps have the potential for being unreasonably high, particularly if the services do not face full competition. Thus, in order to fulfill the

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based, with the burden of necessity on the LEC). WilTel and others consistently have argued for such a simple indexing approach -- also called "benchmarking" -- to pricing transport statutory requirements of Section 201(b) of the Act, and the goals of the price cap plan, the FCC should make revisions in the price cap plan to bring overall price cap rates levels back to the zone of reasonableness.

Price cap levels that are set above cost magnify the potential for discrimination. Unjustifiably high overall price cap ceilings will give the LECs substantial headroom to adjust prices in an anticompetitive and discriminatory fashion. LECs can price noncompetitive services well above cost while lowering more competitive service prices to levels at or below cost without any economic penalty.

Such price discrimination is highly likely to occur given the market pressures faced by LECs in the local exchange and their likely entry into new markets. They will have strong incentives to (1) overprice access provided to competitors, to underprice access provided to themselves, and (2) to overprice services for customers with fewer competitive alternatives while underpricing services where LECs face greater competition and (3) to price new services provided in new markets -- such as long distance and cable television -- at levels that do not bear their share of common costs in order to gain market share. The FCC can help reduce the LECs' ability to engage in predatory or discriminatory pricing by lowering the overall price cap levels to reflect actual costs. 18/

LEC earnings over the price cap review period generally have been far above the 11.25 rate of return set by the FCC in 1990, which, if anything, is now too high given trends in interest rates since 1990. Whatever the cause, the high LEC earnings under price caps mean that price cap rate levels are now far above where they would have been under rate of return and are far above actual cost. It is

18/ We emphasize that any definition of "predatory" pricing must recognize that incremental telecommunications costs in a fiber world are trending toward zero. Hence the focus here, as elsewhere, must be on how LECs recover common costs.

essential that the FCC reset rate levels to reflect actual costs and restore price cap rates to the just and reasonable level required under the Communications Act.

Any overall rate level reductions adopted in this proceeding should be applied to reduce existing discrimination among price cap services. Overall reductions may be sufficient, in fact, to give the FCC room to correct discrimination without requiring LECs to raise the rates for any services. At the very least, rate level reductions should be applied on a service-by service basis. If LECs are allowed to pick and choose which services will benefit from reductions in overall price cap rate levels, the FCC will have done nothing to make individual rates reasonable and nondiscriminatory. Instead, the LECs will decide based on strategic competitive considerations which customers will receive the benefit of lower prices.

<u>Baseline Issue 3: Changes in Productivity Factors or Rate Levels</u>

It is likely that the data collected in this proceeding will lead the FCC to raise the productivity factor to more accurately reflect the declining cost characteristics of telecommunications networks over time. If anything, advances in technology are revealing that unit costs of providing service are falling even faster today than four years ago. High LEC earnings over the price cap period also are a strong indication that the initial productivity factor may have been set too low.

The FCC should adjust the rate of return for price cap carriers to reflect reductions in interest rates since 1990.

<u>Baseline Issue 4: Sharing and Low-End Adjustment Mechanism</u>

The FCC should keep in place the sharing mechanism for as long as the LECs possess market power in any of their services -- into the indefinite future.

If sharing is abandoned, there will be no check on the overall reasonableness of LEC rate levels. Particularly in light of the FCC's adoption of a uniform productivity factor and rate of return for all price cap LECs, the sharing mechanism is a necessary protection to ensure that price cap carriers with above average productivity or below average rate of return requirements do not earn unreasonably high profits. The price cap incentive system provides ample opportunity for price cap carriers to reap the benefits of their efficiency gains and to adopt cost-cutting measures without abandoning the sharing mechanism.

Baseline Issue 5: Common Line Formula

The FCC should revise the 50/50 carrier common line formula to reflect the reality that LECs are not, as a practical matter, able to stimulate interstate usage of subscriber loops, and that the reward for stimulating demand growth over such nontraffic sensitive facilities should go to those carriers that are able to boost such usage: the purchasers of access service. 19/ This is consistent with the position taken by user groups and by interexchange carriers when the formula was adopted in 1990.

Baseline Issue 6: Exogenous Cost Changes

19/ To the extent that LECs are now or will later be in a position to stimulate interstate access usage, through provision of information services or interstate interexchange services, they would do so in the same fashion as their information services or interexchange competitors, and would derive the same benefits through paying reduced CCL charges themselves.

The FCC should tighten the test for exogenous cost changes to strictly limit price increases to economic cost changes that are beyond any LEC control and are not experienced by other sectors of the economy. It is too easy for price cap carriers to game the process by requesting exogenous treatment only for cost increases, and to decline to file requests for comparable exogenous treatment. Processing requests for exogenous treatment also unnecessarily burdens the FCC's already limited resources. Strict treatment of exogenous costs -- whether increases or decreases -- also is consistent with the theory of price caps, which allows carriers to keep the benefits of cost-cutting while protecting ratepayers by capping prices.

Baseline Issue 8: Rates and Regulations for New Services

F. The New Services Test Permits LECs Wide Latitude to Discriminate

The price cap new services test affords the LECs almost unlimited flexibility in pricing new services. It therefore must be revised to ensure that new services rates do not discriminate against competitors or captive customers. The new services test, as presently applied by the FCC, effectively creates a floor (at long run incremental cost) and a ceiling (at fully distributed cost), allowing LECs to price new services at any point in between. Because incremental costs are generally low relative to fully distributed costs, the new services test gives the LECs tremendous latitude to engage in strategic and discriminatory pricing of new services. Almost any price change could be classified as a new service.

Moreover, the test allows LECs to set new service prices at levels very different from the levels of comparable existing services, whose rates were brought into price caps under rate of return principles -- and therefore were based on fully distributed cost. The current new services test thus effectively blesses price discrimination. Not only is this unlawful under Section 202(a) of the Communications Act, it has serious competitive consequences -- consequences that will only be greater as LECs enter markets in which they are direct competitors of the companies to whom they sell necessary services. 20/

The unique cost characteristics of telecommunications networks make it easy for the LECs to engage in price discrimination. The costs of providing telecommunications service are largely fixed and largely shared among all services. Relatively few costs can be directly assigned to particular services. Overhead levels also are high as a percentage of total costs. New technologies only exacerbate these features: fiber optic transmission facilities, large multi-purpose digital switches, and centralized network intelligence, for example, make the job of tagging particular costs to particular services very difficult. 21/

The incremental cost of providing another unit of service also is close to zero over today's networks. Even long run incremental cost is relatively low as a percentage of total cost. If the LEC is allowed to price new services -- or existing services, for that matter -- at incremental cost, the question then arises: who is paying the remainder of the fully distributed amount? And is it fair for some

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20/ As the Commission itself recognized, LECs have the incentive to price new services provided to competitors at an unreasonably high level while pricing new services that face competition too low. Notice at para. 80. The Commission also recognized that customers who have few competitive choices may end up paying unreasonably high prices under price caps. Id. Indeed, the original purpose of the new services test, as stated by the Commission in adopting the price cap plan for AT&T, was to prevent discrimination and anticompetitive behavior through the pricing of new services. AT&T Price Caps Order, 4 FCC Rcd at 3122.

21/ The Commission also should be careful not to confuse changes in the technology used to provide the same services with truly new services. Changes in technology should not be the open door to unlimited pricing flexibility for the LECs.

customers to pay rates based on incremental costs when other customers --- often their competitors --- must pay rates based on fully distributed costs?

The Commission must confront the fact that the new services test, and the price cap scheme in general, permits the LECs to engage in market-based pricing, something the Communications Act cannot possibly permit for carriers that do not operate in a competitive marketplace. 22/

Nor does market-based pricing necessarily lead to efficient use of network facilities. Most LEC network facilities are shared by a multiplicity of services and a multiplicity of customers. The LEC network also has substantial excess capacity. It is engineered to accommodate future needs and peak demand. Fiber facilities in particular have potentially enormous capacity. Today's technology also permits dynamic use of network facilities to accommodate changes in demand for particular services. It is thus far more likely that pricing flexibility will lead to strategic pricing rather than to cost-based, efficient pricing.

These are not just academic issues, or questions of importance to one or two narrow industry segments or customer groups. As the barriers between

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22/ The LECs face little competition today for most of their services. For those services, such as special access and dedicated transport, that are subject to some competition, the market is still far from competitive. More fundamentally, as we have shown elsewhere in these comments, most of access service will continue to be a bottleneck even after local competition is established. LECs will continue to price strategically in that environment; their prices will be designed to limit the ability of competitors to use local bottleneck facilities to reach LEC end users; and LECs will continue to favor their own services and customers over those of competitors. Because of the unique characteristics of local loop facilities, the local market is not likely ever automatically to generate nondiscriminatory or even economically efficient prices. Even assuming the LECs faced competition in some small segments of their market, such as high capacity dedicated transport, for example, the Commission cannot properly conclude that it can safely allow market-based pricing for that market segment. Quite the contrary: partial competition provides even greater incentives for LECs to price discriminate, and to do so in a way that would chill further growth of competition.

markets break down, and LECs enter long distance and video markets, and as new facilities-based companies begin to compete for the heart of the LEC business-- the local subscriber base -- the LECs' incentives to engage in strategic pricing, and to recover common costs in a discriminatory fashion -- will be far greater than they were when price caps were devised, far greater even than they are today. Many, if not most, LEC services will be classified as new services under the price cap rules. In fact, a service is only considered "new" so long as the LEC retains, for some period of regulatory memory, all existing services. Getting the new services test right is essential to preventing such discrimination.

G. The Commission Should Revise the New Services Test By Adopting Sound Pricing Principles

WilTel proposes that the FCC adopt the following five principles for evaluating challenges to pricing new and existing services under price caps. These principles are consistent with the theory of price caps, which is to begin with generally reasonable and nondiscriminatory rates and then permit variations from those rates within certain boundaries. These principles do not stand alone; they must all be adopted together as part of a coherent approach to preventing discrimination. If any one is missing, then the door would be reopened for LECs to discriminate.

1. Require the use of prospective (not historical) costs. The FCC itself prescribed use of prospective costs in pricing ONA services, and most of the parties in the ONA tariff investigation favored that approach. 23/ Forward-looking costing approaches reflect the reality of LEC investment decisions and network usage

23/ Open Network Architecture Tariffs of Bell Operating Companies, CC Docket No. 92-91, at paras. 36-43, 9 FCC Rcd 440, 454-56 (1993).

today, as well as the pricing decisions made by LEC competitors. It is also sound as a theoretical matter to use prospective costs.

2. Use a long-run incremental cost approach to measuring direct cost. If the LECs want to use an incremental cost approach to measure the direct costs of providing a new service, that is fine. But then all service prices should be evaluated using incremental costs, new and old. Any other approach would automatically result in discrimination because only certain customers would end up paying for common costs and overhead, even though all LEC services use the same network and overhead.

3. Require uniform overhead allocations across all price cap services. This point should be self-evident, yet the Commission's new services test departs from this principle substantially. The current rule permits non-uniform overhead allocations to new services, although it requires LECs to explain their loading methodology. It also requires a uniform methodology, that uniformity only applies across "related" services. 24/ It is hard to imagine how non-uniform loadings of overhead could be justified without violating the Act's nondiscrimination requirement. The Commission should therefore revise the new services test to require uniform overhead allocations in every case, and across all price cap services.

In addition to the flexibility already built into the new services test, the FCC also permits non-uniform overhead allocations when a new service is a substitute for an old service that is still available. 25/ This is a dangerous loophole

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24/ See Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Docket Nos. 86-79 and 87-313 ("Part 69/ONA Order"), 6 FCC Rcd 4524, 4531 (1991).

25/ Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Docket Nos. 86-79 and 87-313, 7 FCC Rcd 5235, 5236-37 (1992).

which allows LECs to selectively underprice some services relative to others. If the new service is truly a substitute for all categories of customers, then there would be no takers for the old, higher priced service. In that case, the LECs would have used the exception to circumvent the purpose of the rule. If, on the other hand, there are still some customers for the old service, then the new service is not a true substitute for the old one for all customers, but only for some. The exception again is just a cover for discrimination against customers who have no choices. 26/ These exceptions all demonstrate how poorly price caps promote the principle of nondiscriminatory recovery of overheads from all LEC customers.

4. Allow LECs pricing flexibility but only if accompanied by indexing. The LECs have argued that they need pricing flexibility in order to respond to competition. The Commission can permit that flexibility without also generating unreasonable discrimination by requiring LECs to change prices in parallel -- by "indexing" price changes in one service to price changes in other services. For example, if a LEC wants to reduce prices for dedicated transport in Zone 1, it should also reduce its prices in that zone for tandem-switched transport by a comparable amount. Or if a LEC wants to introduce a term discount for dedicated transport at the DS3 level, it should also make the same percentage term discounts available for DS1 and tandem-switched transport. 27/ Deviations from indexing would be permitted, but only if cost-justified.

26/ Another exception to the rule allows LECs to justify unusually high overhead loadings for new services where a "risk premium" is justified. This loophole presents the potential, for example, that LECs will overprice new services required by LEC competitors

27/ WilTel has made these points in various filings in other proceedings. See, e.g., WilTel Petition for Reconsideration in Docket No. 91-213, filed April 4, 1993; WilTel Comments in Docket No. 91-213, filed Feb. 1, 1993, and Reply Comments, filed March 19, 1993. We argue here that the FCC must adopt a more general

5. Require uniform recovery of other common costs or subsidy amounts on a nondiscriminatory basis across all services. If after pricing all services according the above principles, the LECs still have embedded costs or subsidy amounts that should, as a public policy matter, be recovered from interstate ratepayes, then the FCC should provide for the recovery of those amounts through a nondiscriminatory mechanism across all services. The Act should not permit the LECs to selectively recover the sunk costs of obsolete plant, excessive overheads, or subsidy elements from a selected group of customers -- customers who are likely to have few competitive alternatives or to be the direct competitors of the LECs themselves.

In sum, the FCC must look ahead to the kinds of pricing challenges it will face as the LECs enter new markets and face new competition. If the FCC does not revise the new services test, it will give a green light to anticompetitive pricing. It will not be enough to rely on the principles adopted under the initial price cap plan. This review proceeding presents the perfect opportunity for the Commission to tailor the price cap scheme to accommodate increasing concerns about price discrimination while continuing to allow LECs the necessary pricing flexibility to respond to competition.

12. Relationship to Other Proceedings.

We have set out in an Appendix a partial list of the other proceedings that will raise issues that are likely to be part of the LEC price cap performance review.

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principle, that indexing of rate changes permits LECs pricing flexibility while at the same time guarding against discrimination.

III. TRANSITION ISSUES

As a preliminary matter, we note that the likelihood that full-fledged local exchange competition will develop is sufficiently speculative, and sufficiently far off in the future, that it is unnecessary, and certainly premature, for the Commission to attempt to decide now whether and when it would be appropriate for LEC price cap rules to be relaxed.

But there is a more fundamental reason why the Commission should not consider allowing LEC price deregulation in the future: the LECs will continue to possess market power for most components of so-called "switched access service" even after local exchange competition has arrived. These matters are discussed briefly below in the context of the Notice's questions.

A. Transition Issue 1: Criteria For Reduced or Streamlined Regulation

Issue 1a: Current State of Competition

As the Commission recognizes, competition will develop at different paces for different services in different geographic locations. A preliminary question is whether material local service competition can develop at all. We suggest that a much more rigorous review is necessary of the conditions that are necessary to create opportunities for local service competition, looking beyond the mere removal of legal prohibitions at the state level and incorporating consideration of the practical elements of interconnection and pricing.

Similarly, WilTel would reemphasize that today there is no competition for the provision of tandem switched transport service used to serve smaller markets and customer bases. This problem establishes a continuing need to regulate both tandem service itself, and the relative amount of contribution or other common costs that this service is asked to bear compared to other services used IXC competitors.

The Notice seems to assume that interoffice transport will become competitive as a result of expanded interconnection. However, as a potential customer of CAPs, WilTel is aware of the limitations of those carriers as a substitute for the LECs. We remain almost entirely interconnected with LECs for access today. We view it as an empirical question how rapidly and where viable interoffice competition actually will develop.

As a starting point, we recommend that the Commission's Industry Analysis Division begin collecting complete data on actual use being made of expanded interconnection and related statistics. This information should go beyond very generalized accounts of total revenues of CAPs. The Commission should track where competition actually is present and affecting the access market, and where it is not.

Transition Issue 1b: Criteria for Reduced Regulation of the LECs

B. The FCC Must Correct Price Discrimination Before Considering Increased LEC Pricing Flexibility

WilTel believes that the Commission already has given the LECs excessive pricing flexibility, and that LECs are using this flexibility to discriminate in the recovery of common network costs in ways that distort the markets that require access service as a necessary input to retail services. The Commission should correct those elements of price cap regulation that permit such discrimination before considering other steps to increase LEC pricing flexibility.

As markets begin to become more competitive, as demonstrated by hard data rather than LEC rhetoric, the Commission can use devices such as zone pricing to gradually give the LECs more flexibility to reflect cost differences in their network. However, for the foreseeable future the Commission will have to continue to maintain rules to prevent LEC discrimination in the recovery of common and other indirect costs.

Transition Issue 1c: Bottleneck Facilities

C. LECs Will Continue to Possess Market Power Even After Local Competition Develops

The premise of much of the "Transition" section of the Notice is that at some point in the relatively near future LECs no longer will have bottleneck control over access facilities.

This is a common, but mistaken, understanding of how local competition will develop. Although the introduction of local loop competition will give the customer new choices for a local service provider, it will not necessarily lead to more choices for other services. Bottleneck control over each individual local customer will continue even if there are alternate loop providers. If access to those bottleneck facilities is not maintained, then the market for all other services can become as concentrated as the number of facilities-based local service providers that serve a particular market.

Paradoxically, local exchange competition will not eliminate the market power of the LECs with respect to the local loop; rather, it will lead to a "multi-bottleneck" world in which service providers still will depend on obtaining access to a customer's loop in order to reach that customer. The FCC therefore will need to keep in place indefinitely all the safeguards we have advocated in these comments to guard against LEC access price discrimination.

As a practical matter, each customer will choose only one local loop provider over which it will send and receive its communications. All other service providers will depend upon obtaining access from that loop provider in order to reach the customer and sell the customer services. From the point of view of the service provider, the loop provider (whether a LEC, a cable company, or some other facilities-based provider) is still a bottleneck between the service provider and the customer.

Market forces do not constrain the ability of LECs to engage in discriminatory pricing. It is the end user, not the customer, who has chosen the local service provider. Unless the end user wants to change its local service provider, other service providers are stuck with dealing with that particular loop vendor in order to obtain access to that end user. Put differently, when it sells loop service, the LEC is competing for the end user's business, not for the IXC's or information service provider's business. The LEC therefore faces little or no incentive to hold down access prices; if anything it faces incentives to raise access prices to find local service competition.

Discrimination will becomes an even more serious problem as the lines between local service and long distance, which we take for granted today, become blurred as local competition grows. Those lines are a product of LEC tariffs and related regulatory policies that do not apply to new entrants. For example, MFS recently announced that it would be providing bundled local exchange and long distance service to small business customers in Maryland. 28/ New entrants also will have no reason to track existing LEC local service boundaries. Cable companies, for example, will provide local service within their franchise areas.

Complicating the picture is the trend toward full-service offerings. Local service providers will not sell just local service -- they also will be selling long distance, information services, and cable television service, and will deliver these services over a single local loop. New entrants into the local exchange market are likely, in fact, to use such full service offerings as a way to attract local service customers away from the LECs. LECs, in turn, including eventually even the

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28/ See Telecommunications Reports, May 2, 1994, at 1.

BOCs, will likely be allowed to offer a full range of services in order to respond to the offerings of the new entrants.

If the Commission's long run goal is to guarantee all service providers and customers open access to such networks, then it will not be enough simply to insist that LECs provide interconnection and interoperability. If LECs charge discriminatory rates for access pricing, they will be able to deny competitors the practical ability to provide service to the LEC's local loop customers.

In a multi-bottleneck world, of course, all local service providers, not just LECs, will have the incentive and ability to discriminate in pricing access to loop facilities. The Commission may choose, in a separate proceeding, to consider placing safeguards on nontraditional local loop providers. But for purposes of this proceeding, it is clear that the FCC should not expect to streamline or otherwise deregulate LEC access pricing. Rather, the likely development of local competition into a multi-bottleneck world should lead the FCC to pay even closer attention to building protections against price discrimination into the revisions it makes now to its price cap rules.

The price cap scheme was designed for a time when the LECs did not, for the most part, compete with service providers needing interstate access to LEC bottleneck facilities. The danger of discrimination and predatory pricing will obviously be much greater if LECs gain entry to new markets, such as cable television and long distance.

It may be helpful to remember the battles fought between pre-divestiture AT&T and its upstart long distance competitors over the terms and price of interconnection. Without the FCC's intervention, and eventually the MFJ's equal access provisions and tariffing requirements, long distance competition might not have been a success story. The success of local competition, indeed the future of competition and diversity for all telecommunications services, will require similar vigilance and oversight by government well into the future.

Transition Issues 3,4 and 5: Transition Stages, Basket Revisions, and Further Review

D. It is Premature to Establish Criteria for Revising Price Caps to Respond to as Yet Unknown Market Conditions

It is premature to establish criteria for revising price caps to respond to changes in market conditions given that those changes have not materially begun. Again, we emphasize that the first priority should be to correct the flaws in price cap regulation with respect to discrimination. WilTel has elsewhere suggested that if LEC prices are regulated in a way that avoids unfair differences in the recovery of common and other indirect costs from competitors, other aspects of price caps might even be susceptible to relaxation.

As an access customer, WilTel asks the Commission to reject LEC requests for further deregulation based on "potential competition" arguments or similar theories. The long distance market demonstrates that it takes many years for new entrants even to begin to achieve equal footing in the market with the historical monopoly.

WilTel has no opinion at this time as to how often the Commission should engage in price cap review proceedings in the future. One reasonable approach might be to hold such a review after Industry Analysis Division studies demonstrate the presence of actual and substantial competition in a particular market segment. A final decision on this point is probably best made after price cap rules are revised to address the discrimination problems identified here.

CONCLUSION

Price caps are a new form of regulation that is only a few years old. It therefore is not surprising that this system has weaknesses that require correction. WilTel urges the Commission to give careful attention to how those weaknesses -- particularly with respect to discrimination -- can be corrected to provide consumers with open access to a diverse universe of telecommunications and information services vendors competing on the information highway. That access will not truly be "open" if some vendors must pay a larger share of common costs than others.

Respectfully submitted,

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Its Attorneys

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APPENDIX

Related Proceedings

1. The transport rate restructure proceeding (CC Docket 91-213). WilTel has sought reconsideration on several pricing and cost allocation issues in transport. The Commission should adopt general rules in this proceeding that will address the concerns about discrimination that have arisen in connection with transport but are not unique to that service. For example, WilTel has argued that marginal cost should be used to allocate switch investment to the tandem switching charge, and that overheads should be uniformly allocated across all access services, in order to achieve cost-based, nondiscriminatory access rates.

2. Expanded interconnection (CC Docket No. 91-141). Issues such as the proper design of zone density pricing could be addressed in the guidelines adopted in this proceeding. WilTel's position regarding zone density pricing is that as currently structured, it creates unacceptable discrimination against lower volume customers of transport.

3. Pricing Flexibility. LECs will be asking for increased pricing flexibility in many other proceedings, such as Part 69 waiver requests, tariff filings, and in petitions such as the USTA access reform petition. The Commission should address such issues comprehensively in this price cap review proceeding, rather than in an ad hoc fashion, in order to ensure that price discrimination is not an unintended side effect of pricing flexibility.

4. Ameritech and Rochester petitions. Proper access pricing will be essential if the LECs are to be allowed to provide long distance service and if local

competition is to succeed. The principles adopted in the price cap review proceeding can lay the groundwork for evaluating such individual petitions.

5. Access Reform. Several parties -- USTA, NARUC, and the Ad Hoc Telecommunications Users Committee, have filed petitions asking the FCC to reform its access charge rules. The Commission should adopt nondiscrimination and cost allocation principles in this docket that can be used to resolve those broader access reform questions.

6. Video dialtone. Cost allocation and new service pricing rules should be drafted in this proceeding to take into account the likelihood that most LECs will file tariffs for video dialtone services over the next few years. Protections should be built into those pricing rules to ensure that ratepayers not subsidize LEC entry into new markets such as video.

7. Pending Telecommunications Legislation. Without adequate safeguards to prevent anticompetitive and discriminatory access pricing, neither Congress nor the MFJ court should even consider allowing BOCs to provide interLATA service, even on an experimental basis. The current price cap plan does not contain such protections. Other preconditions, of course, also would have to be met as well.

CERTIFICATE OF SERVICE

I, Vincent J. Summa, do hereby certify that a copy of the foregoing "Comments of WilTel, Inc." was served by hand, on this 9th day of May, 1994, on the following:

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